

SMART INVESTMENTS

Speech of State Treasurer Philip Angelides
to the Commonwealth Club of California

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Thank you very much for having me here today. As your new State Treasurer, I am delighted to report to you today that the condition of the California economy is good and the condition of the California Treasury is sound.

The economic picture for the country also can be painted in bright colors. During the first quarter of 1999, GDP grew at an annual rate of 4.1 percent.

In California, personal income is expected to grow 6.6 percent this year, and the number of jobs will increase by 3.3 percent. Revenues to the State will be up about \$4.3 billion beyond earlier projections.

Taken alone, this is all good news. Good news this fiscal year. Good news next fiscal year. And in the past, these numbers would be the types of statistics upon which most State Treasurers would want to dwell. But today, I want to go well beyond a discussion of the current economy and fiscal health of our State.

I believe that one of my central duties, as the State's fiscal and investment officer, is to articulate which policies and which issues need to be addressed to ensure that today's rosy economic picture is sustained into the decades of the 21st Century. And when we begin to look beyond the next couple of years, we come face to face with some of the most dramatic challenges ever to be faced by Californians.

During the next 20 years, California will add more than five million new jobs. We also will add 12 million new residents, four million new households, and more than two million new children to our school system. This growth will surpass the population increase experienced by California during its first century of statehood. And it will exceed the growth seen during the boom years of the 1950s, 1960s, and 1970s combined.

This surge in growth will not only create the need for new investments, it will add enormous stress to a public fabric already stretched thin by decades of underinvestment. Indeed, if you drove into the city today as I did, I don't need to remind you that there are large pieces of our physical infrastructure that already are overburdened and deteriorating.

The explosion in population and jobs will drive us head-on into two public policy challenges that must be met if we are to remain economically strong in the years ahead.

Our first challenge is to find a way to meet the tremendous demands of projected growth, while preserving those unique environmental qualities that have always made California an attractive state in which to live. Put another way, California's sustained economic success in the 21st Century is inextricably linked to the quality of our environment.

The Center for the Continuing Study of the California Economy makes a very cogent observation on this matter:

“A high quality of life,” the Center says, “is, increasingly, a determinant in attracting entrepreneurs and workers in global industries. ...Failure to protect the natural attractiveness of California can, therefore, hurt the State's future prosperity.”

I will tell you bluntly that the growth patterns now underway in California, combined with the magnitude of the growth we're going to experience over the next 20 years, will threaten California's environmental quality and livability.

Examples of the costs of current development patterns abound. By 1995, Californians were wasting more than 300,000 hours per day sitting idle on congested urban highways. Traffic congestion is not only costing billions of dollars in lost economic productivity – it is a primary cause of the state's poor air quality. Eight of the nation's 15 worst air quality basins are here in California.

Beyond traffic congestion and air quality, the lack of affordable housing is another example of the negative impacts of current growth patterns.

California has 11 of the nation's 25 least affordable housing markets. Since 1995, for every 5.4 jobs created statewide, permits have been issued for only one new housing unit. The resulting housing supply shortage has reached an acute stage. A poll of Bay Area business leaders found that over 90% rated the housing supply problem as an 8, 9, or 10 on a scale of 10.

But we don't need to succumb to the threat of poor planning and environmental degradation. We can preserve and improve the quality of our air and water, enhance the livability of our communities, maintain the beauty of our beaches and mountains, our deserts and our valleys – if we embrace environmentally responsible and thoughtful policies which support more sustainable development at the urban fringe and renewed growth and investment within our existing urban fabric. How we direct infrastructure investment is a critical element of such policies.

The second challenge is to grow in ways that promote equality of opportunity across our

State. Future economic strength will be elusive if there are two Californias – with most of the State experiencing a buoyant economy while simultaneously there are communities suffering from economic decline and devastation.

I began my remarks by saying how well we're doing economically, and how state revenues are up. We're in the midst of a remarkable economic boom. But that's not true in East Palo Alto or in Richmond. It's not true in the Del Paso Heights area in my hometown of Sacramento, or in Lynwood or Compton or Bell in the Los Angeles area. And it's not the case up and down the San Joaquin Valley.

For all our successes, California has the greatest gap between rich and poor of all but four states in this country, and the number of Californians living below the poverty line grew by 28 percent between 1989 and 1996. The Public Policy Institute of California right here in San Francisco says the increasing income gap was caused by "...a precipitous drop in income at the mid-to-lowest levels of the distribution."

Perhaps the hardest hit by this surge in poverty-level income are California children. More than one in five is, today, living below the poverty line.

Our land use policies and practices, and our economic and growth patterns reflect the separation of these two Californias by race, by income, and by class. Look, for instance, at the differences between the older cities and the new suburbs in virtually every region of the State. In the Sacramento Metropolitan area, poverty rates are more than twice as high in urbanized Sacramento County as in the rapid growth areas of suburban and rural Placer County. The poverty gap between these two counties increased by 50 percent in the six years that ended in 1995.

In the Los Angeles area, the effective buying income per capita in Simi Valley is more than twice that for Compton. And here in the Bay Area, poverty is concentrated in the older, more urbanized communities, while income is rising sharply in communities on the urban fringe.

My good friend and classmate from the Harvard Class of '74 – Dr. Cornel West – summed up our situation in one of his more recent books titled *The Future of American Progressivism*. He wrote that we now see...

“...a world of advanced sectors and regions connected with one another and weakly linked to the backward sectors and regions of their own societies.”

I believe Dr. West has it exactly right. There are naturally common interests and communication between the high tech companies of the Silicon Valley and their counterparts in Japan, the United Kingdom, Germany and other parts of the global economy. There's nothing

wrong with that.

But it takes a far greater effort – and leaders who are willing to look far into the future – to link the high tech industry and other vibrant sectors of the California economy to the communities and young people who now constitute the backward sectors and regions of our own society to which Dr. West referred.

As we embark on a new era of investment, let us think about how we direct our public investments in ways which will allow all of California to have a chance to succeed in the 21st Century.

Preservation of the environment and equality of opportunity, with all the implications those goals entail – these are the challenges that I see if we are to sustain our economy and if the “Golden State” is to be worthy of that name in the year 2020.

A previous generation of Californians – faced with a different set of challenges - looked ahead and made investments that strengthened this State for decades. They invested in a public fabric – a great university system, a state of the art transportation network, remarkable water projects – that laid the foundation for a period of historic economic expansion.

But then we sat on our lead. Our charge now is to look ahead again and to make investments with a vision to meet the challenges before us and the vastly changing needs of the next century.

There are many leaders in both the public and private sectors who share these concerns, and stand poised to address them. The Eighth Annual Business Climate Survey, sponsored by the California Business Roundtable and the California Chamber of Commerce, found that 71 percent of the State’s business leaders are concerned about the need for increased public investment.

Just a few months ago, I would have been among that 71 percent, for I came to this job from the private sector. It is from experience that I believe that a working partnership between leaders in the public sector and the private sector can and will meet the challenges we face in California.

Here’s a quick example of what I mean. Ten years ago, when my company was designing and planning a new community in south Sacramento County, I was introduced to the concept of “new urbanism,” now also known as “sustainability” and “smart growth”. I had become concerned about land use trends that resulted in a great disconnect between jobs and housing; increasing segregation of race and class in the suburbs; poor transportation planning; and lack of community design worthy of California’s past and future.

We attempted to address some of those concerns in our Laguna West community. We

designed it for walking among tree-lined streets to village greens. We designed homes with porches and recessed garages and included a wide mix of housing for various incomes. And we placed neighborhoods close to work sites. These are just a few of the “sustainable development” and “quality of life” elements we built into Laguna West. Today, four companies have built about a million square feet of facility space in Laguna West, with homes and apartments nearby. I say this so that you will know that I am not advocating impossible, impractical values and goals.

It is one thing to advocate. It is quite another to roll up one’s sleeves and work on solutions. I propose to do both, and today I am taking the first step. It’s a step that goes beyond the traditional role State Treasurers have assumed, but it’s well within the scope of my duties as the investment officer for the State of California.

This week, I am making public a special update of California’s ***Debt Affordability Report***. This report is required by law to be submitted annually to advise the Governor and the Legislature on how much debt the State can afford to incur for infrastructure investment. In its traditional form, it has been simply a recitation of where we sit fiscally, and what we believe we can afford in the way of debt issuance over the next 10 years. I have chosen to take a more fundamental approach with a much broader view, and that is:

In the next 10 years, how do we invest public resources in infrastructure so that we can stay economically strong and address the dual challenges of environmental quality and equality of opportunity that I have just described.

We have titled our report ***Smart Investments***. It urges a new approach which recognizes that how we spend precious dollars, and the approaches we take to capital investment, can shape the vibrancy of California well into the 21st Century.

The first finding of the report is that California has significant debt capacity, but lacks an investment plan.

Our debt capacity - our ability to borrow over the next 10 years - is about \$32.5 billion – if the State continues to commit the current 4.17 percent of its General Fund to long-term debt. About \$14.7 billion of that debt includes bonds already authorized but not yet issued.

There is some support now for increasing our “debt to General Fund ratio.” If we were successful in raising that ratio to 5 percent over the next five years, we would have about \$43 billion in debt capacity over the next 10 years. And if we make a host of tough policy and spending commitments needed to up the debt ratio to 6 percent, debt capacity would reach \$58.6 billion.

It is important to note for the record that the State’s General Fund debt capacity is in addition to more than \$35 billion in other funds identified by the Department of Finance as

available over the next decade for infrastructure investment. This means that, when you add debt capacity to other funds, we will have anywhere from approximately \$68 billion to \$94 billion for infrastructure investment over the next ten years.

That's a lot of dough. As former United States Senator Everett Dirksen once said "a billion here, a billion there, and pretty soon you're talking about real money".

What has struck me over the past months, however, is that so much of the debate in Sacramento has been about whether we have \$70 billion, \$80 billion, or \$90 billion in infrastructure funding, and what are the needs in pure dollar terms? Not enough of the debate has centered on this question: As we embark on a new wave of investment in California, what are the principles that ought to govern infrastructure investment, and what do we want to accomplish in the years ahead?

While the \$68 billion to \$94 billion available for investment will most likely fall short of needs, it is critical to note that current needs assessments are not based on a comprehensive plan of investment. Nor are they designed to achieve the goals of ensuring sustained economic growth, environmental preservation, and equality of opportunity.

Thus, the first finding in our *Debt Affordability Report* is that we can take on significant debt, but right now the State doesn't have a plan or a vision of what we need to do with the money.

The conclusion is obvious: We need to adopt an investment plan with visionary principles and strategies for the wise use of our precious capital, rather than focusing on additional dollars needed for undefined tasks.

The second finding is that our investment policies ought not be driven by some magic percentage of the state budget – 4.17 percent or 5 percent or 6 percent of the General Fund. Neither should policies be driven by a "laundry list" of projects compiled by state agencies or by interest groups.

Instead, investment should be driven by a set of fundamental questions such as:

Where do we want to be in the 21st Century?

What are the best investments to achieve our goals?

What are the most cost effective ways of making those investments, and what processes and structures will get us there?

No self-respecting corporate entity – and I know this from experience – would ever start its investment discussion around how much money was needed. It would always start around,

“Where do we want to be, and how do we get there via our investment policy?”

With apologies to any Coca Cola executives who may be in the audience, the 1998 annual report for Pepsi stated this principle well. In the section on investment strategy, they put it this way: “So we’ve pursued a strategy you could sum up in two words – ‘focus’ and ‘investment.’ You get your ducks in a row and then put some real money behind them.”

In that vein, I believe that our focus must be on a set of growth principles that best ensure the state’s long term economic strength by preserving the environment, and giving new opportunity to those California communities lagging behind.

Consistent with that focus, the report states a key principle that must be central to any investment plan: Investments that support livable communities, sustainable development, and sound environmental practices strengthen the economy.

This means that our infrastructure investments must support new forms of more sustainable development at the urban fringe, and that more of our infrastructure investments must be redirected into the somewhat tattered fabric of California’s existing communities and neighborhoods that too often have been thrown away in 25-year cycles.

Since this finding involves sustainable development, perhaps I should define it a little more thoroughly. Sustainable development means land uses that support transportation options beyond more freeways and roads. It means a better mix of housing in communities and neighborhoods. It means locating jobs near housing and balancing job growth with new housing, communities centered around civic spaces, and well-planned higher density use of land.

Let me give you one example of how investment policy can support sustainable development. As Treasurer, I chair the California Tax Credit Allocation Committee which annually awards \$450 million in federal and state tax credits to finance the construction and rehabilitation of affordable housing. We have just adopted a new program direction – scoring applications for tax credits in a way that supports sustainable growth. Housing developments are given points for being close to transit, parks and recreational facilities, and retail grocery shopping. Apartments for families are given points if they are located within walking distance of a public school. And points are awarded to projects in existing low-income communities in need of quality affordable housing where a comprehensive revitalization effort is underway.

Our report discusses another element of a “smart investment” strategy – re-investing in declining communities. This is essential, we concluded, to reverse this dangerous trend toward “two Californias,” one in poverty and the other enjoying an economic boom.

We touched on this issue earlier, but I would add this comment, quoting straight from the report:

“A two-tiered California poses a number of threats to long-term economic success. Educational failure will damage the quality of our workforce. Poverty will increase the fiscal burden on state and local governments. Fears for public safety will negatively affect private sector investment decisions. Most importantly, the very essence of the California dream – equality of opportunity – will be lost.”

Infrastructure investment is one tool that can and should be used to revitalize our economically struggling communities. That’s why, as a member of the California Infrastructure and Economic Development Bank, I proposed to make community economic need a baseline requirement for the first \$150 million in local infrastructure financing to be made available by the bank this year.

Now, I have no illusions that infrastructure investment alone is going to be enough to take those places of high poverty and high unemployment and give them new life. That will take concerted action across a range of policy fronts.

Indeed, a recent study in San Diego of 16 high schools shows the breadth of the challenge. The study placed the schools in four quartiles – from the poorest four schools and to the richest four schools in terms of the neighborhoods in which they are located. And what the study said was simple, but it bears repeating.

It showed that the combined SAT scores in the schools in the richest four neighborhoods were 100 points higher than in those in the poorest four neighborhoods. Fifty percent of the kids in the richest four schools qualified for the UC and CSU systems. But only one in five kids in the poorest four schools were qualifying for our great university systems.

The dropout rates in the poorest four schools were five times as high as those in the richest four schools. So clearly, investment in human capital is just as necessary to keep us economically strong as is investment in physical infrastructure.

The next finding in our report is so fundamental that you might wonder at first why it needs to be stated. Yet, given the precious nature of limited public resources and the historical lack of good investment planning in California, we decided that it was essential to this discussion. We stated it this way: Smart investment policy requires a new focus on cost-effectiveness, return on investment, and results to sustain California’s economic growth. This focus is vital to the success of any credible investment strategy.

As examples, here are some of the hard questions that must be asked of any investment proposal:

Is the proposed investment consistent with growth principles that best ensure California’s long-term economic, environmental, and social strength?

Is it the most cost-effective means of achieving the desired results?

Will it provide an adequate return on investment?

When we answer these questions, we need to think in ways that we have not thought before. We cannot afford a discussion that says, “We’ve got four lanes on the freeway and we need five.” It cannot center on the fact that we have “X” number of facilities, and we need “X + Y.”

A smart investment plan moves away, in my mind, from a discussion that’s just about more and more conventional facilities, to a discussion about, “How do you effectively spend precious public dollars to achieve the public policy result that we believe is best?”

For example, a smart investment plan needs to consider not just more water conveyance facilities, but how do you reallocate water rights, how do you increase conservation of water so that we don’t need to spend billions on new water projects.

From 1970 to today, despite a growth of one million people, the City of Los Angeles uses no more water than it did 29 years ago. That’s because of changed conservation practices and public policies that encouraged change.

Since 1977, Californians have saved more than \$16 billion in energy costs - the equivalent of constructing 11 new power plants, through energy conservation and new technology.

Let me give you a tangible example of a smart investment. The “Cool Schools” program is planting trees and replacing asphalt with landscaping at elementary schools in Los Angeles. An average of 88 trees will be planted at each of 40 schools, and 30 percent of the asphalt in the schoolyards will be replaced with landscaping. The trees and landscaping will cool the schools, create energy cost savings of 12 percent to 18 percent and reduce the need for air conditioning equipment. In addition to the savings, the trees will beautify urban neighborhoods.

And we need to look not just at how many prisons we need to build, but what are other ways – whether it’s mental health, substance abuse, or youth employment programs that may be more cost-effective approaches. We’ve gone from spending \$400 million a year in 1982 to over \$4 billion this year on incarceration programs, and the fact is, we need to find a smarter way.

New avenues may not always be the easiest to explore since they may challenge existing orthodoxy and the political status quo. Yet, the prudent stewardship of public resources demands new directions.

The next finding in our *Smart Investments* report recognizes that how we structure our capital financing decisions is fundamentally important. The report puts it this way: The State’s investment plan must rely on strong regional planning to meet its objectives.

California needs a comprehensive state capital planning process to evaluate, scrutinize and prioritize the investments needed to achieve the State's economic growth objectives. When we establish this process, we must recognize that strong regional planning is essential to achieving the goals of environmental sustainability and community reinvestment. Providing affordable housing, reaching a balance between jobs and housing, preserving open space and developing efficient transportation systems are all matters that reach beyond city and county boundaries.

Increasingly, business and civic leaders are stepping forward to promote regional cooperation. From Joint Venture:Silicon Valley to the Bay Area Council's Capital for Communities Initiative to the Great Valley Center, communities are focusing on regional solutions.

It's time that the State did the same. It is absolutely essential that the tens of billions of dollars which the State will expend for infrastructure be invested in support of strong and credible regional plans.

I also believe, and the report states, that regions must be empowered to finance investments of regional significance.

Finally, and I know this is controversial, communities need majority vote approval for local capital investments in schools, parks, libraries, and other important community projects. The State can't do it all and local communities are best suited to make decisions about neighborhood projects.

We just completed a study of how local special tax measures and general obligation bond measures fared on last November's ballot. We found that 98 percent of those local measures for education would have passed if we had majority vote rule in the state. Twenty-seven local bond and tax measures "failed" in November 1998 while getting greater than 60 percent voter approval.

I might add that I was pretty darn grateful to get 53 percent of the vote in that same election!

Our study showed that majorities in many communities are prepared to invest in their future. They should be allowed to do so.

If we are serious about weaving a public fabric that will allow us to sustain ourselves into the 21st Century – we need to couple a new investment dynamic at the state level with empowerment of local communities to take their own actions to revive their own struggling neighborhoods and to enhance their quality of life.

We are on the verge of a great era in California. It will be an era of explosive growth, and the intelligence with which we handle it will define our future.

In closing, let me return again to my good friend Dr. West who, in another one of his books, “Race Matters”, talked about another era of hope and challenge.

Dr. West speaks about the 1960s and two great challenges which faced this country – poverty and the racial divide. He notes that the 1960s were a watershed period because we decided as a people to overcome the racial divide and to declare war on poverty.

Within two years of that decision, all legal barriers to African American civil rights and voting rights were erased. Within eight years, one half of American poor people were lifted out of poverty.

We made a difference then and we can make a difference now for California’s future.

We can make California, in the 21st Century, a model of economic success over the long term if we stay environmentally strong, and if we become a state that defines its success by throwing open the door of opportunity for everyone to participate.

Thank you for asking me to speak to you today, and to describe a vision for investing in our future.

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